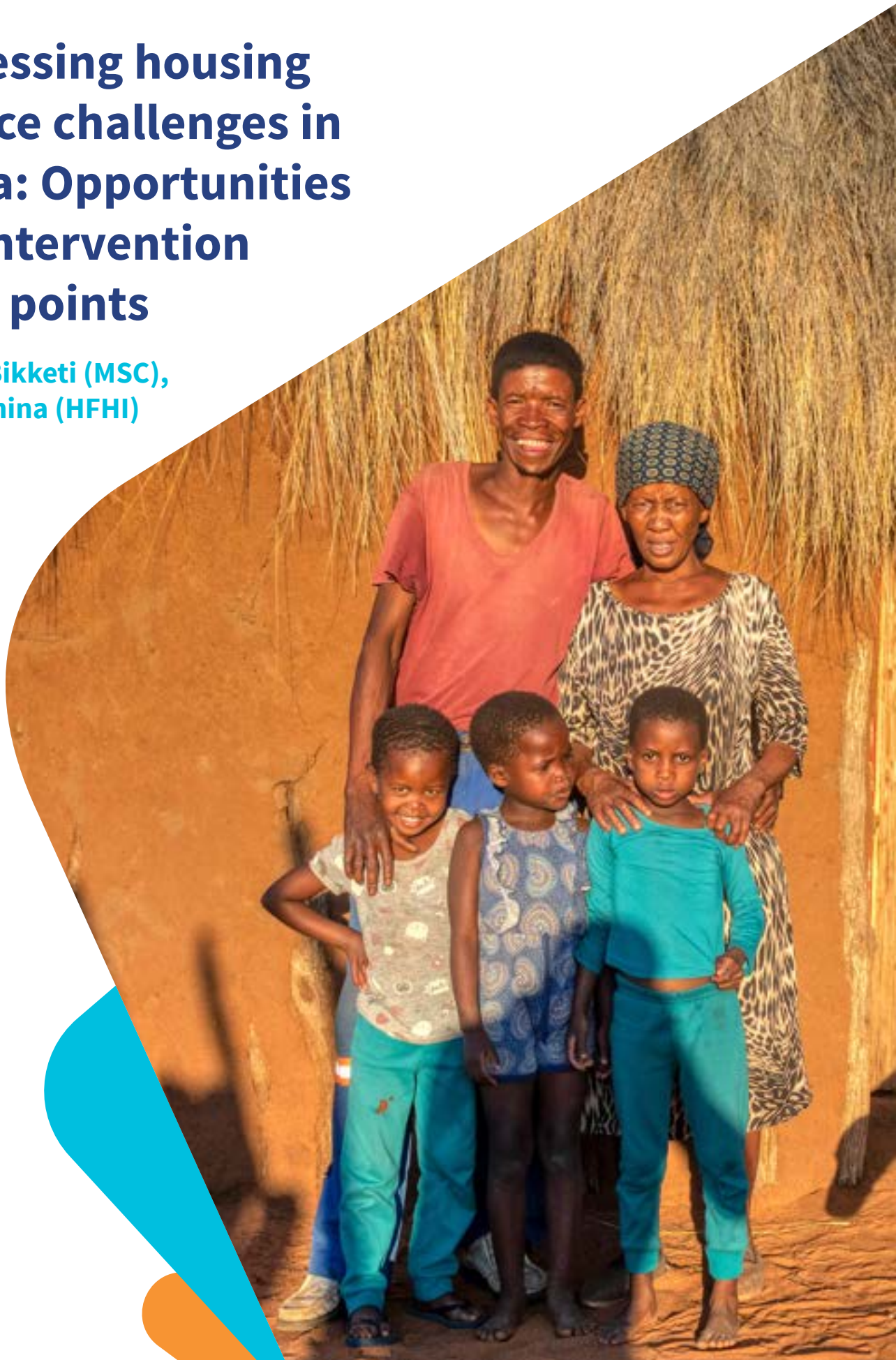


Addressing housing finance challenges in Kenya: Opportunities and intervention entry points

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Executive statement



Kenya is a key economy in East Africa. It boasts a strategic location, robust capital markets, political stability, and a vibrant private sector, which makes it an attractive investment destination. Housing is pivotal to the country's pursuit of higher living standards and economic growth, per Habitat for Humanity Terwilliger Center and Kenya Women Microfinance Bank, 2018.

Despite emphasis from the government on affordable housing for low- and middle-income (LMI) households, challenges in housing finance profoundly impact the availability, affordability, and quality of housing. This study employed a mixed-method approach across various counties and revealed limited access to housing finance, particularly for informal employment (29.2% access) compared to formal employment (56.2% access). Barriers to housing finance include high interest rates, costly materials, formal documentation needs, informality, and inadequate collateral.

The study suggested several strategic interventions. These include incremental housing solutions, alternative credit scoring, increased funding, collaborations, capacity building, tailored financial products, enhanced data access, and technology-driven approaches.





Key messages and recommendations

Problem



Key challenges that affect housing finance for LMI households include high interest rates, expensive building materials, and stringent formal documentation requirements. Moreover, informal income sources and a lack of collateral make this group less appealing to financial institutions, which limits their financial access. Other factors that deter potential investment compound the situation. These include inadequate land tenure rights and limited essential infrastructure, such as water, electricity, and transportation.

Recommendations

- **Recommendation 1:** Promote incremental housing development by supporting self-built housing through innovative and affordable housing finance solutions
- **Recommendation 2:** Invest in Research 4 Development (R4D) for the housing sector to bridge data gaps, establish an open data portal, conduct regular national surveys, and collaborate with partners
- **Recommendation 3:** Enforce policy reforms to support the redesign and implementation of national housing policies, develop housing finance strategies, and foster an enabling environment
- **Recommendation 4:** Forge more partnerships and collaboration to support resource mobilization for affordable housing





Problem statement

Adequate shelter, a fundamental human right, extends beyond basic infrastructure. It encompasses land amenities, such as schools, hospitals, markets, dispensaries, administrative facilities, and water and sewage facilities crucial to human habitation and family growth. However, many Kenyans live in substandard temporary shelters or low-quality housing, which severely impacts their overall wellbeing. Accessibility to credit for housing improvement in rural areas remains a challenge.

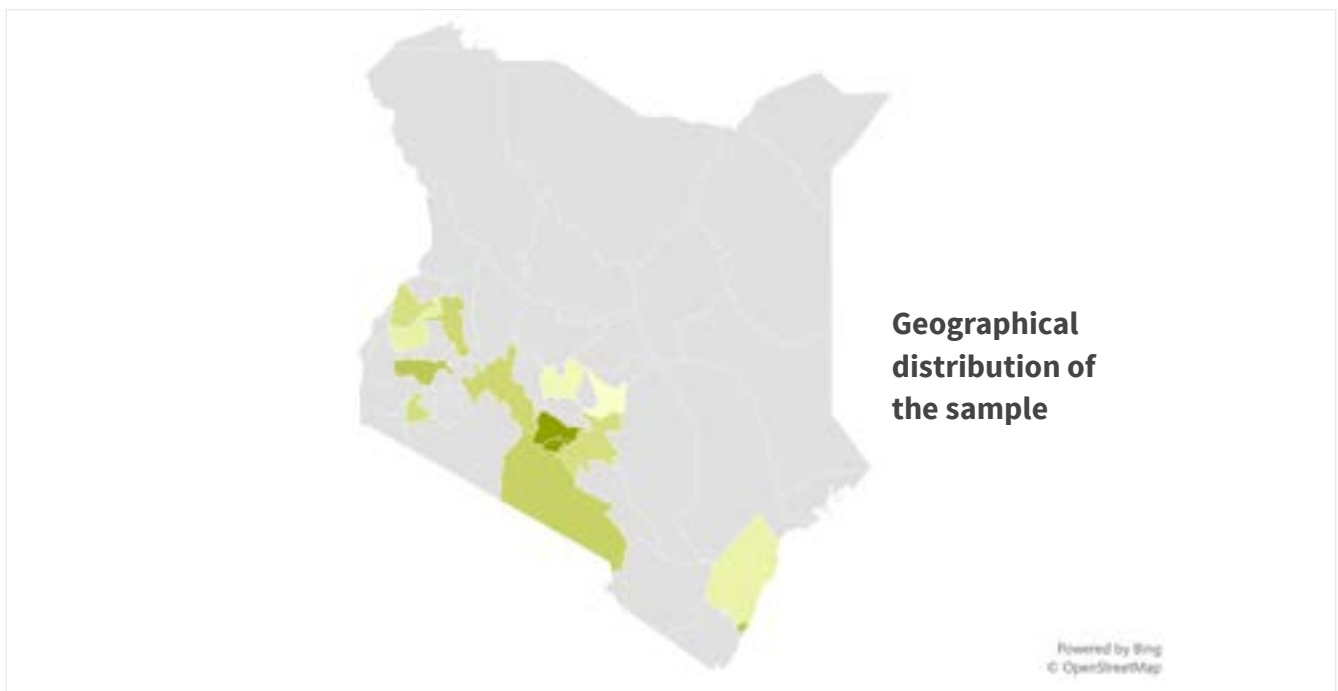
Commercial entities predominantly facilitate housing finance in Kenya, which leaves those in poverty or with alternative land tenure options with limited and often unaffordable financing choices. The existing housing deficit poses a considerable challenge despite governmental efforts and constitutional provisions for accessible, adequate housing. Approximately 46.5% of Kenya's urban population lives in slums. The country struggles with an annual housing gap of 250,000 units, with limited data accounting for incremental housing processes, which primarily affects the low-income segment. Developers predominantly cater to the upper-middle and high-end markets and leave the low-income group vastly undersupplied. This gap highlights the pressing need for comprehensive housing solutions, per the Center for Affordable Housing Finance in Africa (CAHF 2022).





Background of the study and project

Habitat for Humanity International's (HFHI) Terwilliger Centre for Innovation in Shelter (TCIS) partnered with **Kenya Mortgage Refinance Company (KMRC)** and **Association of Microfinance Institutions (AMFI-K)** in a strategic multi-year partnership. The collaboration seeks to establish **TCIS** as a pivotal institution that delivers housing finance to Kenya's low-income households. TCIS's program approach is shifting from direct market intervention to an Integrated Systems Approach to Incremental Housing Processes (ISA2IHP). As a non-profit organization, HFHI facilitates access to decent housing for the low- and middle-income (LMI) segments through a vast network of partners, which include national habitat organizations, corporations, financial service providers, NGOs, government agencies, and stakeholders.



This study highlights housing as a pivotal driver that helps achieve several Sustainable Development Goal (SDG) targets and outlines its broad-reaching impacts. Housing is a substantial household expense. Investments intrinsically tied to finance are indispensable for a well-functioning financial sector to meet diverse societal needs (Habitat for Humanity, 2021). Adequate housing positively influences health, education, and nutrition, reduces infant mortality, and enables access to essential amenities. It fosters a sense of community, financial stability, and job opportunities. Furthermore, housing is a prerequisite for inclusive, safe, and sustainable cities.

However, people in Kenya, especially from the LMI segments, struggle to access housing finance due to systemic barriers, even though it is a fundamental global human right. This study sought to transparently evaluate, unpack, and characterize systemic hurdles on the supply and demand sides that prevent access to affordable and equitable housing finance and its use. The study also intended to develop a roadmap for interventions in the Kenyan housing finance sector. HFHI commissioned MSC (MicroSave Consulting) to undertake this study.

The study's overall objective was to conduct comprehensive market research to address the systemic barriers that impede access to housing finance and its use in Kenya. Its specific objectives were to:

01

Evaluate the knowledge, attitudes, social norms, and perceptions of LMI earners on access to housing finance and its use;

02

Analyze relevant policies, regulations, and laws that affect housing finance accessibility;

03

Assess the business characteristics and institutional factors that influence housing finance accessibility and their impact on borrowing decisions;

04

Map housing finance products and stakeholders in the current market;

05

Identify the challenges, needs, and opportunities of both demand-side players (LMI individuals, incremental builders) and supply-side players (MSMEs and FSPs);

06

Pinpoint factors that hinder housing finance access and use in Kenya;

07

Devise an intervention roadmap that diverse stakeholders, that is, the government, **KMRC**, **HFHI**, and **AMFI-K**, can adopt to foster an enabling environment to enhance access to housing finance and its use.

The study used a mixed method approach that comprised desk review, secondary research, and primary qualitative and quantitative research design. The approach collected and analyzed data to generate evidence and address the objectives. The study's total sample size was 680 respondents interviewed from 11 counties: Bungoma, Embu, Kajiado, Kakamega, Kiambu, Kilifi, Kisii, Kisumu, Machakos, Mombasa, Nairobi, Nakuru, Nyeri, and Usain Gishu. The sample consisted of key informant interviews (KIIs) for supply-side respondents, focused discussion groups (FDGs), and in-person demand-side quantitative interviews.



Study results

Demand-side challenges



- **Cost of housing:** The mortgage lending rates and associated costs are high, while the supply of affordable housing is low.
- **Low-income levels and inconsistent incomes:** Most LMI people have irregular and unstable incomes because of informal employment. At the same time, financial institutions offer credit exclusively to customers with formal employment and stable incomes.
- **Negative perceptions:** Lending to LMI is considered a high-risk activity, which limits their access to affordable housing finance solutions.
- **Complex application processes and collateral requirements:** This excludes most LMI customers because they do not meet eligibility requirements.
- **Lack of suitable customized credit products for LMI people:** Generally, customers with a negative perception of mortgages are afraid of default and have a poor understanding of different products on offer, which has also contributed to the low uptake.
- **Bureaucratic land registry process:** Land titling and transfer processes remain problematic due to bureaucratic structures characterized by complex approvals from the government that are lengthy, expensive, and susceptible to corruption.

Supply-side challenges



- **SACCOs and MFIs are the most preferred formal sources for housing loans:** They provide favorable eligibility requirements, have convenient locations, and enable easy accessibility to members and guarantors.
- **VSLAs dominate informal sources of finance:** Borrowers favor village savings and loan associations (VSLAs) due to their local presence, simplicity, speed, cost-effectiveness, and member control over group management. However, many VSLAs lack formal financial institution relationships for housing finance.
- **Banks have complex processes:** The LMI segment is aware of bank products but favors financing from microfinance banks (MFBs), microfinance institutions (MFIs), and SACCOs instead. They prefer banks less due to complex processes, lengthy processing times, and individual borrowing biases. Collateral requirements from banks often disqualify LMI people when they attempt to obtain bank loans.



Comparison of business models to serve LMI segments

- **Banks and SACCOS are the most trusted:** Customers trust banks and SACCOS for financing. Yet, often, low-income customers do not meet the funding criteria, which compels them to explore alternative options.
- **MFBS and MFIS are well positioned to serve the LMI segments:** MFBS and MFIS reach rural populations well. Yet, they face challenges, such as high interest rates and short repayment periods due to liquidity issues and inadequate funding.
- **Mismatch in lending approaches:** MFBS and MFIS successfully serve the low-income segment but struggle to secure funding due to a mismatch with KMRC's lending model. KMRC mandates land title deeds, contrary to MFBS and MFIS that typically serve people without access to title deeds.



Challenges that face financial institutions that provide housing finance solutions to the LMI population

- **Commercial banks:** Lending costs remain high, driven by operational expenses and perceived credit risk, especially for the LMI segments. A bureaucratic registry process with prolonged government approvals for property documentation, registration, and transfer introduces delays and complexities. The LMI market's informality presents further hurdles for commercial lenders to assess creditworthiness accurately. Moreover, a notable trend has emerged among some individuals in Kenya who prefer consumer loans over mortgages to fund their homes and property ownership, which indicates diverse attitudes toward housing finance.
- **SACCOS:** In housing finance, SACCOS encounter substantial hurdles. Firstly, people, especially from the LMI segments, struggle to secure adequate funds to support housing finance, which poses a considerable challenge. Secondly, the LMI market's informal nature makes it difficult for lenders to assess creditworthiness accurately due to imprecise income measurements. Lastly, a critical issue is the lack of adequate resources within SACCOS for essential training and awareness initiatives. This leads to significant information gaps that hinder effective support for housing finance.
- **MFIS:** Several significant challenges persist. Firstly, funding and liquidity limitations constrain SACCOS, which hinder their ability to provide affordable and accessible housing finance options. Additionally, information asymmetry on LMI customer needs and inadequate engagement structures widen the gap for lenders to address their housing requirements. The LMI market's informal nature further complicates lenders' ability to assess creditworthiness effectively. Lastly, capacity-building constraints, particularly around limited abilities to develop housing finance products and evolving staff skill requirements, present hurdles—especially for MFIS as they attempt to adapt to housing finance lending.



Emerging lessons and opportunities



Customers trust banks and SACCOs and would prefer to get financing from them. However, low-income customers do not meet the criteria for financing in most cases.



The data landscape for housing investment is scant: Despite some progress, available data on the housing investment landscape remains sparse, which continues to hinder the functioning of efficient housing markets.



The private sector has increasingly expressed interest in the affordable housing sector: New players continue to enter the market to address niche market opportunities, which have improved the investment environment.



Product innovation suggests new opportunities to overcome the systemic barriers in housing finance: The value chain has points of innovation worth attention that can contribute to broader sector-level gains.



The LMI segment struggles with limited financial literacy and cannot provide collateral, which hinders their access to formal finance.



Financial institutions have a limited understanding of housing finance, particularly when they serve low-income clients to meet their affordable housing finance needs.



The potential for incremental building to address the housing finance needs of a significant proportion of the low-income population remains untapped.



Recommendations

Recommendation 1: Product development and innovation to match the needs of Kenya's LMI people

Incremental housing development is urgently needed to support self-built housing, alongside a focus on innovative financing solutions. Alternative credit scoring methods, asset registry, and minimal collateral requirements could address informality challenges. Tailored housing finance products are vital and offer flexible repayment terms, lower interest rates, and reduced prerequisites for low- and middle-income (LMI) households. Technology-driven solutions, such as blockchain, data-driven credit scoring, and digital platforms, are essential. Additionally, cost reduction strategies through customer education, streamlined processes with technology, and innovative financing models are key for enhanced housing finance accessibility.

Recommendation 2: Policy reforms to support Kenya's national housing sector

Key steps here will require stakeholders to reform national housing policies, develop housing finance strategies, and create an enabling environment. This would include the formulation of a comprehensive national housing policy that encompasses strategies to enhance housing finance access and develop affordable housing. Additionally, a priority is to create a conducive environment for developers and investors and promote economic growth to ensure affordable housing for all citizens.

Recommendation 3: Investment in Research 4 Development (R4D) for the housing sector

More investments in R4D for Kenya's housing sector will help bridge data gaps, establish an open data portal, conduct regular national surveys, and collaborate with partners, such as FinAccess, for comprehensive housing finance information. Enhanced data collection and analysis are critical to shape policies and programs that boost the availability of housing finance.

Recommendation 4: Forging more partnerships and collaborations to support resource mobilization

More public-private partnerships are needed to enhance housing finance availability and create a sustainable housing finance system. Funding for housing finance initiatives must increase, including grants or low-interest loans to financial institutions. A credit guarantee fund must be established to make housing credit more accessible. Technical assistance and capacity building must be provided to address supply-side capacity constraints. Financial literacy and consumer awareness must be increased through targeted financial education programs, especially for LMI households.



Acknowledgments

The MSC (MicroSave Consulting) team thanks the technical teams of **Habitat for Humanity International (HFHI)**, **Association of Microfinance Institutions-Kenya (AMFI-K)**, and **Kenya Mortgage Refinance Company (KMRC)**. Daniel Mhina (Associate Director, Housing Finance), Lyndsey Czapansky (Senior Specialist, Housing Finance Systems), Hellen Waigwa (Manager, Housing Finance Systems), and Dzenita Kicic (Housing Finance Consultant) led the team from **HFHI**. Hillary Kibet (Research Project Assistant) represented **AMFI-K**. Carlos Makhandia (Research and Strategy Officer) represented **KMRC**.

We are grateful for their collective guidance on the project. Their contributions were significant in the research framework design, research tool development, stakeholder engagement, and quality reviews. They initiated discussions with various stakeholders nationwide, after which MSC scheduled discussions and held interviews.

The MSC team consisted of Edward Bikketi, Pauline Katunyo, Willis Ogutu, Emma Odera, and Shalom Mbugua.



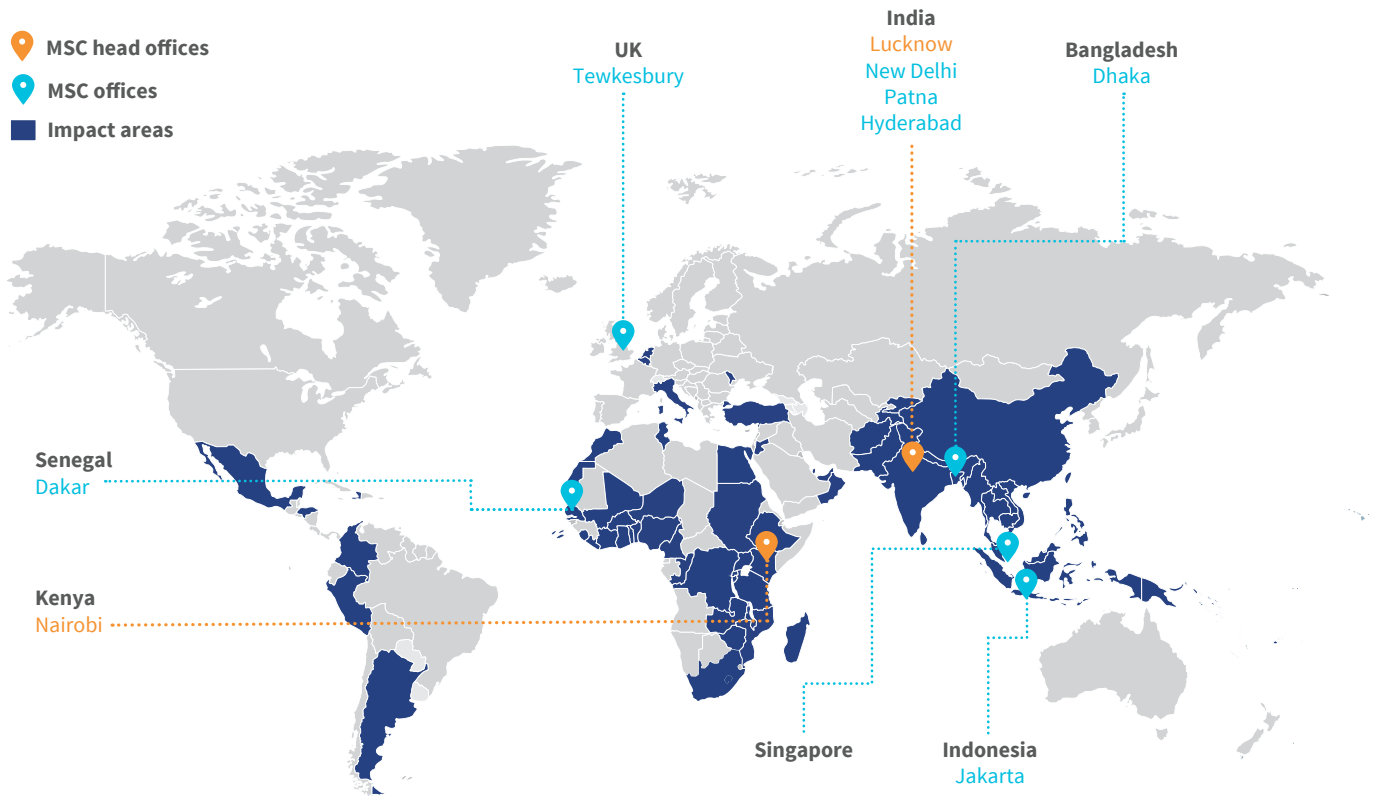
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Publication details: ©MicroSave Consulting and ©Habitat for Humanity International Kenya. January, 2024.

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